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RUEHBJ/AMEMBASSY BEIJING 2005
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RHEFDIA/DIA WASHINGTON DC
RUEHDBU/AMEMBASSY DUSHANBE 3180
RHMFIUU/HQ USCENTCOM MACDILL AFB FL
RHMFISS/HQ USEUCOM VAIHINGEN GE
RUEHIL/AMEMBASSY ISLAMABAD 2284
RUEHBUL/AMEMBASSY KABUL 2308
RUEHLO/AMEMBASSY LONDON 1834
RUEHNE/AMEMBASSY NEW DELHI 2233
RUEHFR/AMEMBASSY PARIS 1624
RUEKJCS/SECDEF WASHDC
RUEHKO/AMEMBASSY TOKYO 1650
RUEHNO/USMISSION USNATO 1792
RUEHVEN/USMISSION USOSCE 2043
RUCNDT/USMISSION USUN NEW YORK NY
RUEAIIA/CIA WASHDC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHML/AMEMBASSY MANILA PRIORITY 0176
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SUBJECT: A LOOMING COTTON CRISIS IN TAJIKISTAN

REF: Dushanbe 1285

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11. (SBU) Summary: International banks have begun calling in part of their \$360 million in agricultural loans to Tajikistan, which lacks the ability to pay, threatening a liquidity crisis in the banking sector here. Behind the scenes of this week's Sixth Ministerial Conference of the Central Asia Regional Economic Cooperation in Dushanbe, the international financial institutions will grapple directly with key Tajik government officials on how to handle the immediate crisis and how to make the sector profitable in the future, including a strong recommendation that the government enter into a new International Monetary Fund program. The international community will try to use this opportunity to push the Tajik government to implement painful agricultural reforms. End Summary.

Looming Macroeconomic Crisis

12. (U) Over the past year, external shocks from inflation and the global credit squeeze have hurt Tajikistan's fiscal health (reftel). Increased prices of food and energy resources in particular have resulted in 12-18% annual inflation in 2007. In addition, the government's 2008 budget is attempting to squeeze increased revenues from a relatively few generators of tax revenues. Reviewing the Tajik state budget, World Bank's Annette Dixon characterized Tajikistan's fiscal policy as "going to hell in a handbasket."

13. (SBU) The international development banks have begun to come to some agreement on what the key issues are and how to resolve them. The Asian Development Bank is focused mostly on a perceived liquidity crisis in the financial system. In response, they have prepared an \$80 million budget support program to pay off international investors. The World Bank is looking at the cotton debt's impact on the overall macroeconomy, and would like Tajikistan to reenlist in an International Monetary Fund program to help monitor and control fiscal and monetary policy. Both international banks have the ear of the government's key decision makers, although the Asian Development Bank maintains a closer relationship to the government.

14. (SBU) Both the World Bank and Asian Development Bank plan to use their meetings with President Rahmon over the weekend to convince him that the government's fundamental management of fiscal policy is falling apart, and to go back on an International Monetary Fund Poverty Reduction and Growth Facility program. Under this program, which is specifically not a bailout, the government would receive funds, along with a policy framework and monitoring program that help keep the government on target. The International Monetary Fund will reiterate to President Rahmon that Tajikistan is not eligible for the Policy Support Instrument, which is designed for more advanced low-income countries and which the IMF Board rejected for Tajikistan last year.

The Cotton Debt - Sovereign Guarantees?

15. (SBU) The Tajik government has quietly disclosed the nature and amount of the external loans related to cotton debt. These loans total \$373 million, and are largely owed to German and Kazakh banks, including KazCommerce Bank, ATF Bank, Deutsche Bank, Commerce Bank of Germany, and Paul Reinhard. Credit Invest is a non-banking institution under control of the Tajik

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National Bank that inherited the cotton debt and must pay off these loans.

16. (SBU) The first of these loans are coming due at the end of November. Due to the credit crunch in Kazakhstan, the international banks are predicting that Kazakh banks will make Tajikistan pay up on its loans rather than roll them over. The World Bank's Annette Dixon told the Ambassador November 2 that Tajikistan has \$200 - \$320 million in reserves available, and the government has not requested a bailout from the IMF to pay off the debt.

17. (SBU) According to Dixon, if the Tajik government had failed to disclose to the IMF that it had guaranteed loans while under an IMF program, it would be in breach of its agreement and theoretically obliged to pay back the IMF. So far, no one in the international financial institutions has actually seen the loan agreements. It is likely that the government provided oral guarantees to the international banks rather than written sovereign guarantees underwritten by the Minister of Finance. It is unclear whether Tajikistan can be legally held to these oral guarantees. The Government of Tajikistan may also try to cut a deal with Kazakhstan by giving away other assets, including mining or energy rights, as a way to pay down the debt. However, the international financial institutions will advise the Tajik government against a fire-sale of the country's assets.

Cotton Debt Resolution

18. (SBU) The World Bank remains wary of the Asian Development Bank's \$80 million proposal to relieve the cotton debt. The World Bank feels that investors made plenty of money over the years from cotton profits and should largely write off the remaining debt, which Annette Dixon described as "fake." The World Bank also does not know how the Asian Development Bank

will structure its budget support program. At the request of the Tajik Prime Minister in May 2007, the Asian Development Bank hired Recovery Partners, a high-profile Canadian debt restructuring consulting company, to examine the Tajik debt. According to the ADB's Betty Wilkinson, since August, the government provided Recovery Partners information on the amount and nature of the debts that alarmed the Asian Development Bank, who then ensured the information was given to the International Monetary Fund.

¶9. (SBU) The Asian Development Bank insists their program will be based on government performance. According to the ADB, the key questions regarding the debt are: Is the debt legally enforceable? And is it within farmer ability to re-pay? The Asian Development Bank's consultants presented their debt restructuring proposal to the government and have received general approval on the approach. The World Bank informed the Ambassador that the Asian Development Bank meanwhile is seeking additional funds for its debt resolution program. ADB's Betty Wilkinson approached EmbOffs to query whether the United States could forgive the \$17 million in official debt to buy into the ADB's cotton debt restructuring program.

Cotton Reform

¶10. (SBU) The government approved a cotton sector reform roadmap earlier this year, which is designed to provide farmers the

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freedom to farm what they choose, promote land reform, and remove government interference from the agricultural sector. The donor community is engaged with the Tajik government and with the private sector to implement reforms as laid out in the roadmap. Land reform and freeing up farmers from government control are top priorities. The government dragged its feet on both these issues this year: the draft land reform legislation went through several undesired revisions, and President Rahmon continues to demand cotton quotas from his regional governors. Several weeks ago, he lambasted the Khatlon Governor for not meeting cotton targets, calling to mind the days of central planning. The combined diplomatic and donor corps sent a letter November 2 to the government expressing its desire that the reform process be taken seriously.

¶11. (SBU) At a donor briefing November 1, members of the Principals' Group in Dushanbe asked the Asian Development Bank if cotton is a viable economic product for Tajikistan, after the ADB showed figures indicating Tajikistan's cotton yield at a meager 1.60 tons per hectare - a third to half less than in neighboring countries. Betty Wilkinson of the Asian Development Bank gave three reasons why cotton is viable in Tajikistan:

- Tajikistan has plenty of water;
- Tajikistan has a cold winter and few pests to kill off the crop;
- The world's biggest cotton user China is right next door.

¶12. (U) Comment: After farmers remove land that is less viable for cotton use from production, remaining areas should be able to produce a competitive product. Vertical mechanisms for buying and selling, though flawed, are already in place. Also, Tajikistan has the potential to produce long-staple cotton, a higher and more valuable grade of cotton for export. China, though nearby, has not been a major purchaser of Tajik cotton. End Comment.

Funding next year's crop

¶13. (U) The World Bank has a \$7 million loan guarantee program to attract new investors and break the current financing monopoly in order to sow next year's cotton crop. Dixon estimates that this will cover half of the \$80-\$100 million necessary to plant the crop. The USAID credit development authority program will supply at least an additional \$5 million

of liquidity for non-cotton agricultural loans starting next year. Agricultural observers will watch next year's planting closely for signs of whether the harvest will be sufficient to produce a living income for the population, and also to provide cotton sticks that rural residents use to heat their homes in the winter.

¶14. (U) All parties want to see the "investors" taken out of the picture of funding the cotton crop, but the Asian Development Bank warned donors that this process should be done slowly because the local banking sector is not ready to take over agricultural lending from investors. The Asian Development Bank's program will help banks build up their technical and financial capacity.

¶15. (U) Comment: The situation is likely to evolve rapidly over the next few months. The Asian Development Bank remains the lead on cotton debt sector reform, and their local representative will remain a key partner for coordination. The

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government's actions will be key for the development of Tajikistan's economy. End Comment.
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